

Doctrinal Determinants, Domestic and International, of Federal Reserve Policy 1914-1933

Barry Eichengreen
Dallas
September 2013

Here I focus on the role of international factors in those doctrines and conceptions

- That being the charge I was given for this paper.
 - I argue that international considerations were part, but only part, of the constellation of factors shaping the Fed's outlook and policies in the gold standard era.
 - However, neither was the influence of international factors negligible (as sometimes argued).
 - And their importance waxed and waned with circumstance, personality, and the changing influence of competing doctrines, as I demonstrate in an analysis of successive episodes.

This emphasis on doctrines:

- Is a useful way of highlighting the contested role of international considerations in Fed policy in this period.
- Appropriately, it serves to remind us that there was never a single monolithic doctrine informing Fed policy.
- It is also a way of associating individuals (and human agency) with that policy (since different individuals were influential in advancing different doctrines at different times).



So what were these monetary/
central-banking doctrines?

Gold Standard Doctrine

- Gold standard rules and, more broadly, the gold standard mentalité were standard central banking doctrine in this period.
- Starting with the Federal Reserve Act and its gold cover ratios.
 - Gold inflows and outflows signaled need to adjust policy.
 - Not that the Fed ever operated a mechanical gold standard (holding excess reserves throughout this period).
 - But the gold standard was not just a statutory requirement; also a mentalité. (Reserves were not all that mattered.)



Real Bills Doctrine

- Long history stretching back to the likes of Henry Thornton.
- Echoed by such founding fathers as Charles Conant, J. Laurence Laughlin and H. Parker Willis and channeled in 1920s by Adolph Miller.
- Enshrined in the “elastic currency” terminology of the Federal Reserve Act.



Riefler-Burgess Doctrine

- Advanced by Randolph Burgess at the NY Fed & Winfield Riefler at the Board.
- Emphasized (offsetting) interaction of discount rate changes and open market operations.
- Pointed to interest rates as the only adequate summary statistics for the stance of monetary policy.



Warburg Doctrine

- Advanced by the German-American financier Paul Warburg.
- Emphasized the advantages of internationalizing the dollar.
 - For both US exporters and financiers.
- Privileged developing a market in trade acceptances.
 - An instrument which, it turned out, was also convenient for intervening in financial markets.



Strong Doctrine

- Strong's views are not easily summarized.
- He sympathized with Warburg Doctrine.
- Was sensitive to the role of the central bank in managing the financial system, having been through the crises of 1907 and 1914.
- Advised by Irving Fisher and others who emphasized the desirability of stabilizing the price level.
- Close to Bank of England Governor Montagu Norman, attuning him to the role of the U.S. central bank in helping to manage the gold-standard system.
- Understood that the U.S. depended on international trade and finance, and that stable exchange rates worked to the advantage of the country by encouraging commodity exports and foreign lending.



Strong Doctrine

- Having embraced all these goals, it followed that Strong was no rigid adherent of the real bills doctrine.
- Rather than looking exclusively at interest rates, he looked also at money and credit aggregates when gauging the stance of policy and at the price level when evaluating its effects.
- Believed in discretionary policy: he opposed formal rules for targeting stable prices and specifically came out against legislation to this effect.
- Comfortable with using the Fed's discretionary powers to sterilize gold inflows in violation of gold-standard doctrine, if doing so was necessary to achieve other targets, such helping a stable price level or Britain onto gold.



Harrison Doctrine

- In my view, the difference from Strong was primarily one of temperament, not doctrine.
 - This is not surprising, since Harrison served as Strong's deputy for the better part of nine years.
- Harrison shared Strong's view of the desirability of the gold standard and that the Fed had an important role in the maintenance of financial stability.
- But where Strong was willful and assertive, Harrison was thoughtful and reflective; in the turbulent circumstances of the early 1930s he was unable to unify his colleagues behind his policies.



Harrison Doctrine

- If there was a doctrinal difference , it was that Harrison was less attuned to the role of the central bank in the maintenance of price stability and more inclined toward the Riefler-Burgess Doctrine.
- He was also more inclined to defer to other Fed officials when they interpreted events in Riefler-Burgess terms.
- Thus, he was prepared to conclude from the fact that interest rates were low after 1929 that monetary policy was accommodating.



Glass-Steagall Doctrine

- By relaxing collateral requirements on Federal Reserve notes, Glass-Steagall was a move away from gold standard doctrine.
- By expanding the range of securities against which the Fed could lend, it also constituted a rejection of the Real Bills Doctrine.
- It was an acknowledgment that the central bank should have the flexibility to pursue other goals such as price stability, economic stability and financial stability.
- As such it was a transition in thinking from earlier conceptual frameworks to the monetary views of Franklin Delano Roosevelt and his Brains Trust.



Episodes

- Post-WWI Recession
- Easing in 1924 and 1927
- The Great Crash and its Aftermath
- 1931 Tightening
- 1932 Open Market Purchases

Post-WWI Recession

- This episode is representative in that we see a combination of domestic and international factors at work.
 - High US gold ratios were now falling, dictating tightening on Gold-Standard Doctrine grounds.
 - So the Fed tightened starting in November 1919.
 - Preserving the US gold standard also set the stage for restoration of the international gold standard.
 - As emphasized by the Strong Doctrine.
 - Board pointed to lending for speculative activity.
 - Hence the Real Bills Doctrine also pointed to tightening.

Easing in 1924 and 1927

- Considerable controversy about both episodes. My reading is that international considerations were dominant, but there is room for disagreement.
 - International considerations pointed to by Strong Doctrine were prominent in both periods.
 - Also periods of gold inflows. So Gold Standard Doctrine pointed in same direction.
 - But activity was weakening in both instances, placing downward pressure on rates, so the Riefler-Burgess Doctrine also counseled loosening.

The Great Crash and its Aftermath

- As is well known, the Fed loosened and provided emergency liquidity in the SR, but then mistakenly concluded that its work was done. Here, I think, is a clear case where domestic considerations dominated.
 - The Strong Doctrine dictated emergency lending.
 - In the SR, the Gold Standard Doctrine dictated tightening but was disregarded.
 - In the LR, the Riefler-Burgess Doctrine indicated that the central bank's work was done.

1931 Tightening

- No question in this case that international considerations dominated.
 - Preceded by extensive efforts at international cooperation, by New York Fed in particular.
 - Some more extensive and successful than others.
 - Occurred after Britain's departure from gold.
 - Tightening was a clear response to gold outflows.

Open Market Operations of April- August 1932

- Gold losses accompanied the expansionary open market operations, and Gold Standard Doctrine dictated tightening in August.
- The skeptics (Bordo et al. and Hsieh-Romer) argue that new gold cover ratios were never threatened.
 - I of course am an impartial arbitrator.
 - My view, for what it's worth, is that Gold Standard Doctrine was not just a statute but also a mentalité, and this remained influential.

Conclusion

- Early years were a period of intense doctrinal contestation.
- Where some doctrines placed more weight on international factors than others.
 - The influence of different doctrines waxed and waned as a function of personnel and personality.
 - Their influence varied with circumstance: gold standard doctrine was more likely to be influential when the Fed's gold cover ratio was low than when it was high; and the Strong doctrine emphasizing the importance of a stable international monetary system was more likely to influence central bank policy when that system was under threat.
 - There were also differences of opinion on the importance of international considerations in different parts of the Federal Reserve System – differences that manifested themselves in conflicts between New York and other Reserve Banks.

And what light does modern central banking doctrine shed on this era?

- It suggests that the Fed was right not to ignore conditions in the rest of the world. What happened in the UK or Germany didn't stay in the UK or Germany, as highlighted by the events of 1931.
- That said, Federal Reserve officials could have dealt more wisely with the international aspects of policy.
- Attempting to reconstruct an international gold standard along prewar lines in social, political and economic circumstances that were now radically changed was not wise. Once that decision was taken, however, the Fed either should have either supported that system wholeheartedly or else acknowledged that the experiment was a failure and abandoned it. The half-measures taken in 1931 to support Austria, Germany and the United Kingdom solved nothing.

Implications for Today

- Even a central bank with good reason to worry about economic and financial conditions in the rest of the world will achieve nothing if it fails to attend first to the health and stability of its own economy.
 - This was true of the Fed in the 1920s and 1930s.
 - The same is true today when we hear calls for the Federal Reserve to abandon policies tailored to the needs of domestic stability in order to address problems in the rest of the world.

- Thank you for your attention.